investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Offshore	03-Mar-05	330	**3,883**	4,829
Infosys	30-Dec-03	689	**1,886**	2,013
Lupin	06-Jan-06	403	**666**	840
Opto Circuits	13-May-08	338	**333**	460
Tata Chem	31-Dec-07	411	**372**	535

ITC

Apple Green

Stock Update

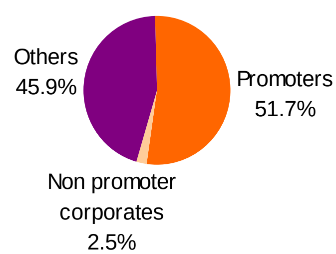
All is well

Buy; CMP: Rs206

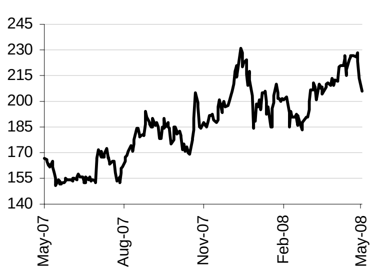
Company details

Price target:	Rs247
Market cap:	Rs77,463 cr
52 week high/low:	Rs239/150
NSE volume: (No of shares)	60.7 lakh
BSE code:	500875
NSE code:	ITC
Sharekhan code:	ITC
Free float: (No of shares)	182.0 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.8	6.7	15.7	31.1
Relative to Sensex	1.0	11.0	30.6	11.9

Result highlights

- ITC registered a growth of 16.7% year on year (yoy) in its net sales to Rs3,934.4 crore during Q4FY2008. The sales growth was led by strong growth in non-cigarette FMCG and agri-business revenues and was slightly higher than our expectation of Rs3,865 crore.
- The operating profit margin (OPM) for the quarter declined by 104 basis points to 26.6% as against 27.6% in the corresponding quarter of the previous year. This was mainly because of the rise in the raw material cost, as the raw material cost as percentage of sales increased by 274 basis points to 46.9% as compared to 44.1% in the same quarter last year. Thus, the operating profit increased by 12.3% yoy to Rs1,044.7 crore during the quarter.
- A jump of 60.0% in other income to Rs163.7 crore (higher than our expectation), helped the net profit to grow by 13.1% to Rs735.6 crore during Q4FY2008.
- Despite a 6% increase in excise duty and imposition of a 12.5% VAT, cigarette volumes declined only by 1% as against our expectation of 2.5% for FY2008.
- The non-cigarette FMCG business continued its remarkable progress with a 48.1% revenue growth. The segment loss increased to Rs117.9 crore on account of the increase in the brand building activities on new product launches in the personal care category. Increase in commodity prices such as wheat, vegetable oil, maize and skimmed milk powder are imposing pressure on the margins of branded packaged food business.
- Agri business regained its growth momentum in the second half of FY2008. Consequently, agri-business revenues increased by 16.1% to Rs1,078.1 crore and the profit before interest and tax (PBIT) margin improved to 3.4% for Q4FY2008.
- We continue our bullish stance on the stock and maintain our Buy recommendation with a price target of Rs247. At the current market price of Rs205.7 the stock trades at 17.9x its FY2010E earnings per share (EPS) of Rs11.5.

Results table (stand-alone) Rs (cr)

Particulars	Q4FY08	Q4FY07	% yoy	FY2008	FY2007	% yoy
Net sales	3,934.4	3,371.9	16.7	13,947.5	12,369.1	12.8
Other income	163.7	102.3	60.0	610.9	336.5	81.6
Total income	4,098.1	3,474.1	18.0	14,558.4	12,705.6	14.6
Total expenditure	2,889.7	2,441.6	18.4	9,543.6	8,412.9	13.4
Operating profit	1,044.7	930.3	12.3	4,403.9	3,956.2	11.3
Interest	2.7	-0.1	-	4.6	3.3	40.5
Depreciation	121.5	92.2	31.8	438.5	362.9	20.8
Profit before tax	1,084.2	940.4	15.3	4,571.8	3,926.5	16.4
Tax	348.5	289.7	20.3	1,451.7	1,226.7	18.3
Reported profit after tax	735.6	650.7	13.1	3,120.1	2,699.8	15.6
OPM (%)	26.6%	27.6%	-104bps	31.6%	32.0%	-41bps

Q4FY2008 performance—as per expectation

ITC's operating revenues for Q4FY2008 grew by 16.7% yoy to Rs3,934.40 crore. The sales growth was ahead of our expectation primarily on account of strong growth in non-cigarette fast moving consumer goods (FMCG) and agri-business revenues. The OPM for the quarter stood at 26.6% against 27.6% in Q4FY2007 due to higher raw material cost, as the raw material cost as percentage of sales increased by 274 basis points to 46.9% as compared to 44.1% in the same quarter last year. Thus, the operating profit grew by 12.3% to Rs1,044.7 crore. A jump of 60.0% in other income to Rs163.7 crore (higher than our expectation) helped the net profit to grow by 13.1% to Rs735.6 crore during Q4FY2008. For FY2008, the company's sales registered a growth of 12.8% to Rs13,947.5 crore and the net profit grew by 15.6% to Rs3,120.1 crore.

Segment-wise gross revenues Rs (cr)

Particulars	Q4FY08	Q4FY07	% yoy
FMCG - cigarettes	3,583.0	3,294.0	8.8
FMCG - others	738.4	498.5	48.1
Hotels	339.3	304.4	11.5
Agri business	1,078.1	928.7	16.1
Paperboards, paper & packaging	620.0	533.4	16.2
Total	**6,358.8**	**5,558.9**	**14.4**

Segment PBIT

Particulars	PBIT (Rs cr)			Margins (%)		Chg in
	Q4 FY08	Q4 FY07	% yoy	Q4 FY08	Q4 FY07	bps
FMCG-cigarettes	870.1	741.7	17.3	24.3	22.5	177
FMCG-others	-117.9	-48.3	-	-16.0	-9.7	-627
Hotels	142.8	117.1	22.0	42.1	38.5	362
Agri business	37.0	8.7	326.9	3.4	0.9	250
Paperboards, paper & packaging	122.7	97.2	26.3	19.8	18.2	158
Total	**1054.7**	**916.2**	**15.1**	**16.6**	**16.5**	**10**

Cigarettes

Despite a hefty increase in taxes, a 6% increase in excise duty and an imposition of 12.5% value added tax (VAT) in FY2008 that led to a 20% price hike by ITC, cigarette volumes declined marginally by 1% as against our expectation of a 2.5% drop for FY2008. ITC has suspended the production of non-filtered cigarettes owing to the steep excise duty hike proposed on non-filter cigarettes in the Union Budget 2008-09. The suspension of the production of non-filtered cigarettes is a temporary action and would be reviewed by the company in the coming months. We expect that a substantial chunk of non-filter cigarette smokers will graduate to regular filter cigarettes due to the price hike in the former. ITC being the industry leader in regular filter category would benefit on account of this shift on account of the growth in volumes as well as the increase in overall realisation due to the change in sales mix with higher proportion of sales of the high revenue yielding and more profitable filter cigarette category.

Non-cigarette FMCG business

- **Branded packaged foods**

The company's branded packaged foods business (includes bakery, staples, confectioneries, ready-to-eat and salty snacks) continued to expand rapidly with sales growing by 60% during FY2008. *Bingo* (a range of potato chips and finger snacks) acquired a double-digit market share just within one year of its launch on the back of continuous growth traction along with wider distribution across target markets.

- **Biscuits**

The biscuit category continued its growth momentum with sales growing by around 4% during the quarter. During the quarter, ITC entered into premium packaged cookie segment by introducing *Golden Bakery* cookies in three variants choco nut, butter nut and butter scotch. The packaged cookie market is estimated at 16% of the overall biscuit market and is growing at the rate of 17% in value terms. ITC will be competing with Britannia's *Good Day* in this segment, which is the market leader with a 60% market share.

- **Staples**

In the staples category, *Aashirvaad Atta* remains the market leader with revenue growth of 43%. The recently launched *Aashirvaad MP Chakki Atta* has registered a good consumer response. *Aashirvaad* spices grew by 49% leveraging the in-house agri-sourcing and crop development skills.

- **Confectionery**

The confectionery category recorded robust sales with revenues growing by 40% during FY2008. In this category the portfolio was expanded with the launch of new variants in *Minto*, *Natkhat* and *Candyman* range during FY2008. Effective distribution system and aggressive trade marketing coupled with strong supply chain have helped the category overtake the market leaders.

- **Lifestyle retailing**

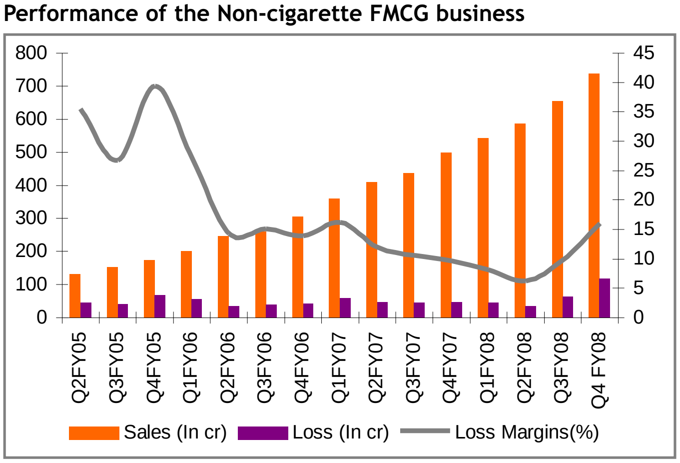
Lifestyle retailing business showed an impressive growth of 26% during the year. The introduction of the *Essenza Di Wills* and *Fiama Di Wills* range of personal care products at *Wills Lifestyle* outlets has helped augment the lifestyle portfolio. ITC continued to increase its retail footprint with an addition of six new stores in this quarter taking the total count to 50 stores. However soaring rental costs have hampered the pace of store expansion.

- **Personal care**

In Q2YFY2008, ITC forayed in the personal care segment by launching *Fiama Di Wills*, a premium range of shampoos and shower gels. This was further expanded with the launch of *Fiama Di Wills* soaps and *Superia* range of soaps and shampoos to penetrate the mass consumer market. The basket of products is being progressively extended at national level and the recent launch of range of soaps under the *Vivel Di Wills* and *Vivel* brands has further augmented the portfolio.

The non-cigarette FMCG business of ITC has shown consistent growth in terms of revenues, which for the quarter have grown by 50.1% yoy to Rs655.4 crore. The segment loss increased to Rs117.9 crore (a margin loss of 16.0%) on account of the increase in the brand building activities on new product launches in the personal care category. Increase in commodity prices such as wheat, vegetable oil, maize and skimmed milk powder are imposing huge pressure on the margins of branded packaged food business. The segment as a whole is expected to continue its strong growth in the top line as ITC expands the portfolio of offerings and strengthens distribution of existing products. However going forward the business has to face huge challenge in the shape of an unprecedented rise in input cost. With ITC spending on brand building and introducing new products to become a major player in the Indian FMCG market, near-term profitability would remain subdued. However we believe this would lay a strong foundation for sustaining the growth for the segment.

Performance of the Non-cigarette FMCG business



Hotels

The hotel segment registered a steady revenue growth of 11.5% for the quarter driven by an improved REVPAR and a stellar performance of the food and beverages segment. The segment continues to maintain healthy PBIT margins that improved by 362 basis points to 42.1%. The construction of super deluxe luxury hotels at Bengaluru (having 300 rooms expected to be commissioned by December 2008) and Chennai (having 550 rooms, commissioning within 15 months) is on track. Fortune Hotels (100% subsidiary of ITC) has a tie up with Parsvnath Hotels, a wholly owned subsidiary of Parsvnath Developers to manage 50 hotels across the country in the next three to five years. More than 4,000 rooms would be constructed under the brand name of *Fortune Select*, *Park*, *Inn* and *Faith*. In the first phase of plan, the joint venture would manage seven projects in various cities.

Paperboards, specialty paper and packaging

The business registered an impressive growth of 16.2% in the revenues with an improvement in the volumes of the value-added portfolio of paper and paperboards and the strong performance of the packaging business. Continuous operating efficiencies led to a 26.3% growth in PBIT and 158 basis points improvement in PBIT margins during Q4FY2008. With the recent commissioning of the new pulp capacity at the Bhadrachalam unit, pulp capacity has increased from 1 lakh tonne per annum to 2.2 lakh tonne per annum. This will bring in cost efficiencies and remove the dependency on imported hardwood pulp, the prices of which have seen a sharp rise and have adversely impacted the margins of the company. The incremental pulp capacity is also sufficient to support the requirement of the new paper machine with a capacity of 1,00,000 tonne per annum (which is expected to be operational in FY2009).

Agri business

Agri business regained its growth momentum in the second half of FY2008 and retained its position as a prime player in agri commodities with strong performance in soyabean trading. Consequently, agri-business revenues increased by 16.1% to Rs1,078.1 crore and the PBIT margin improved to 3.4% for Q4FY2008.

Valuation and view

We would closely monitor the consumer response to the increase in excise on non-filter cigarettes that would lead them to shift to filter cigarettes or *bidis*. ITC's moves in this regard would be clear in the near future. We continue our bullish stance on the stock and maintain our Buy recommendation with a price target of Rs247. At the current market price of Rs205.7 the stock trades at 17.9x its FY2010E EPS of Rs11.5.

Earnings table

Particulars	FY2007	FY2008	FY2009E	FY2010E
Net profit (Rs crore)	2,700.0	3,120.1	3,630.2	4,338.7
Shares in issue (crore)	376.2	376.2	376.6	376.6
EPS (Rs)	7.2	8.3	9.6	11.5
yoy chg (%)	18.2	15.6	16.2	19.5
PER (x)	28.7	24.8	21.3	17.9
Book value (Rs)	27.7	32.0	38.0	45.9
P/BV (x)	7.4	6.4	5.4	4.5
EV/EBIDTA (x)	18.8	16.5	14.2	11.7
EV/Sales (x)	6.1	5.2	4.4	3.7
RoCE (%)	34.9	34.0	34.5	35.2
RoNW (%)	27.7	27.8	27.6	27.5

Ashok Leyland

Ugly Duckling

Stock Update

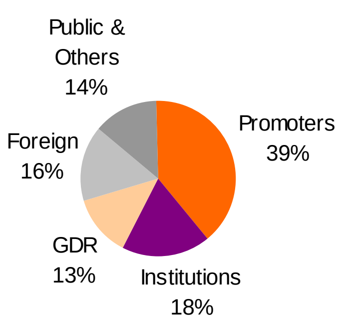
LCV capex higher than expected

Hold; CMP: Rs37

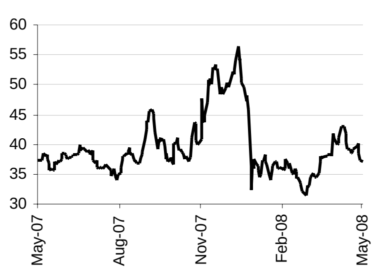
Company details

Price target:	Rs43
Market cap:	Rs4,922 cr
52 week high/low:	Rs57/26
NSE volume: (No of shares)	61.7 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Sharekhan code:	ASHOKLEY
Free float: (No of shares)	63.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-10.4	3.7	-6.7	0.3
Relative to Sensex	-10.3	7.9	5.3	-14.4

Details of joint venture with Nissan Motor

Ashok Leyland and Nissan Motor Company have legally formed the three joint venture companies for the light commercial vehicle (LCV) business in India to manufacture vehicles and powertrains, and to develop technology. This follows the signing of the master co-operation agreement between the two companies in October 2007.

- **Ashok Leyland Nissan Vehicles Pvt Ltd:** This company will have the exclusive rights to manufacture LCVs in India for both the partners. The manufacturing facilities will be located in India and will be majority owned by Ashok Leyland. The enterprise will involve a capacity of 100,000 vehicles a year in the first phase and the capacity will be scaled up subsequently.
- **Nissan Ashok Leyland Powertrain Pvt Ltd:** This company will be responsible for the manufacture and assembly of engines and other drive train components to be fitted in the LCV products and for exports. The manufacturing facility will be located in India and the company will be majority owned by Nissan Motor Company.
- **Nissan Ashok Leyland Technologies Pvt Ltd:** This company will develop LCVs and related powertrains for the Indian and identified emerging markets. This joint venture company will be owned 50:50 by the two partners. The products developed will be sold under both the company's own brands and the Nissan brands.

Project cost marginally higher: The proposed investment in all three companies at around Rs2,300 crore or $575 million is marginally higher than the earlier project cost of US$500 million.

The plants are expected to start production from FY2010-11. The product range would comprise LCVs of up to 7.5 tonne and an all-new generation Nissan Atlas f24 light-duty truck.

This announcement is expected to increase Ashok Leyland's already high capital expenditure for the next three years. The persistent slowdown in the commercial vehicle industry and the higher debt being raised by the company to finance its capital expenditures are expected to exert pressure on its financials and restrict its profit growth.

At the current market price of Rs37, the stock quotes at 8.8x its FY2010E earnings and 5.8x its FY2010E earnings before interest, depreciation, tax and amortisation (EBIDTA). We maintain our Hold call on Ashok Leyland with a price target of Rs43.

Earnings table

Particulars	FY2006	FY2007	FY2008	FY2009E	FY2010E
Net sales (Rs cr)	5,329.8	7,168.2	7,729.1	10,446.8	11,682.4
Net profit (Rs cr)	327.0	441.3	466.4	495.9	556.9
% y-o-y growth	*20*	*35*	*6*	*6*	*12*
EPS (Rs)	2.1	3.4	3.5	3.7	4.2
% y-o-y growth	*20*	*35*	*6*	*6*	*12*
PER (x)	17.3	11.0	10.6	9.9	8.8
P/BV (Rs)	3.5	2.6	2.3	2.0	1.8
EV/EBIDTA (x)	8.7	7.0	7.0	6.1	5.8
RoCE (%)	21.7	26.7	25.7	22.4	21.3
RoNW (%)	20.2	23.6	21.8	20.6	20.3

Sharekhan Stock Ideas

Evergreen

Housing Development Finance Corporation
HDFC Bank
Infosys Technologies
Larsen & Toubro
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Apollo Tyres
Bajaj Holdings & Investment
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Suzuki India
Lupin
Nicholas Piramal India
Punj Lloyd
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Tata Motors
Tata Tea
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Tourism Finance Corporation of India

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Axis Bank (UTI Bank)
Balaji Telefilms
BL Kashyap & Sons
Cadila Healthcare
Jindal Saw
KSB Pumps
Navneet Publications (India)
Network 18 Fincap
Nucleus Software Exports
Opto Circuits India
Orchid Chemicals & Pharmaceuticals
Patels Airtemp India
Television Eighteen India
Thermax
Zee News

Ugly Duckling

Ashok Leyland
Aurobindo Pharma
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Genus Power Infrastructures
ICI India
India Cements
Indo Tech Transformers
Ipca Laboratories
Jaiprakash Associates
KEI Industries
Mahindra Lifespace Developers
Mold-Tek Technologies
Orbit Corporation
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Selan Exploration Technology
SEAMEC
Shiv-Vani Oil & Gas Exploration Services
Subros
Sun Pharmaceutical Industries
Surya Pharmaceutical
Tata Chemicals
Torrent Pharmaceuticals
UltraTech Cement
Union Bank of India
Unity Infraprojects
Wockhardt
Zensar Technologies

Vulture's Pick

Esab India
Orient Paper and Industries
WS Industries India